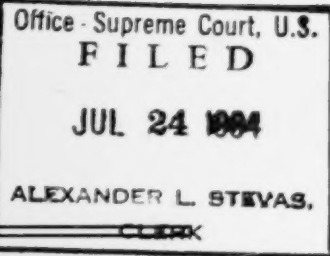


84-129

No. _____



IN THE
Supreme Court of the United States
October Term, 1984

IN RE FLIGHT TRANSPORTATION
CORPORATION SECURITIES LITIGATION.

REAVIS & McGRATH, a partnership,
Petitioner,

v.
FRANK P. ANTINORE, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Jerold S. Solovy*
Joan M. Hall
JENNER & BLOCK
One IBM Plaza
Chicago, Illinois 60611
(312) 222-9350
Attorneys for Petitioner

*Counsel of Record



QUESTIONS PRESENTED

1. Whether the procedures for settling a class action may be substituted for the express requirements of Chapter 11 of the Bankruptcy Reform Act of 1978 when more than 80% of the net assets of the bankrupt's estate will be distributed pursuant to a Sharing Agreement among competing claimants?

2. Whether the provisions of Section 510(b) of the Bankruptcy Reform Act of 1978 supersede the provisions of Section 541 of the Bankruptcy Act in determining whether the proceeds of a public offering that are subject to a claim of constructive trust should be included in the bankrupt's estate?

3. Whether the district court can approve a settlement in a multi-district class action and bankruptcy proceeding without preparing findings of fact, conclusions of law, or any opinion explaining its decision?

STATEMENT REQUIRED BY RULE 21(b)

The proceedings in the court below involved the claims of petitioner-appellant Reavis & McGrath and respondents-appellees Frank P. Antinore, Sid Bader, Dennis Barr, Caroline J. Bender, Barry Bernstein, Dolores and Robert Bezark, James P. Christopher, Sylvester E. Daily, Jr., Ethel Dimicele, James J. Donohue, Ron Fingerhut, Kristi A. Fogarty, Robert L. Gold, Andrew Goodman, Emil Gotschlich, Theodore Herman, Joyce Hill, Ronald Knuth, Dennis A. Koltun, Stanley F. Koutek, Milt Krelitz, Carmen and Eugene Kreuzkemper, Grant Lovelle, James Lovelle, Joseph Mangano, Donald Miller, Phyllis Miller, Gordon Moscoe, Dennis Rease, Phil Richter, Maureen Schleiffer, Richard Schwartzchild, Ann Seaver, Bruce Shankman, Ellyn and Robert Stein, Marvin Steinberg, James Walsh, Allan Ziskin, Putnam High Yield Trust, United High Income Fund, Inc., and Oppenheimer High Yield Fund. The other parties in the court below were Drexel Burnham Lambert Incorporated, Moseley, Hallgarten, Estabrook & Weeden, Inc., Greyhound Leasing and Financial Corp., Continental National Bank & Trust Co. of Chicago, Norwest Bank Minneapolis, N.A., Norwest Bank Calhoun-Isles, N.A., the receiver of Flight Transportation Corp. and its subsidiaries, Fox & Company, Jack Adams, Jr., Russell T. Lund, Jr., Wardwell M. Montgomery, Delbert Oldenberg, Marjorie Terhaar, Larry Walston, Walston Wings, Inc., Lunds, Inc., and Edward Brunner.

TABLE OF CONTENTS

	<u>Page</u>
QUESTIONS PRESENTED.....	i
STATEMENT REQUIRED BY RULE 21(b)	ii
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	2
JURISDICTION	2
STATEMENT	2
The Court of Appeals Proceedings	4
REASONS FOR GRANTING THE WRIT	5
I. THE EIGHTH CIRCUIT'S DECISION, WHICH PERMITS THE PARTIES TO THE SHARING AGREEMENT TO DISPOSE OF MORE THAN 80% OF THE ASSETS OF FTC'S ESTATE WITHOUT COMPLYING WITH THE EXPRESS REQUIREMENTS OF CHAPTER 11, DIRECTLY CONFLICTS WITH PRIOR DECISIONS OF THE SECOND AND FIFTH CIRCUITS	5
II. THE EIGHTH CIRCUIT FAILED TO GIVE EFFECT TO THE UNAMBIGUOUS MEANING OF THE WORDS USED IN SECTION 510(b) ..	10
III. THE DISTRICT COURT ABDICATED ITS RESPONSIBILITY TO PREPARE FINDINGS OF FACT AND CONCLUSIONS OF LAW SETTING FORTH THE BASES FOR ITS DECISION TO APPROVE THE SHARING AGREEMENT	13
CONCLUSION	15
TABLE OF APPENDICES.....	A-i
APPENDICES	A-1

TABLE OF AUTHORITIES

Cases

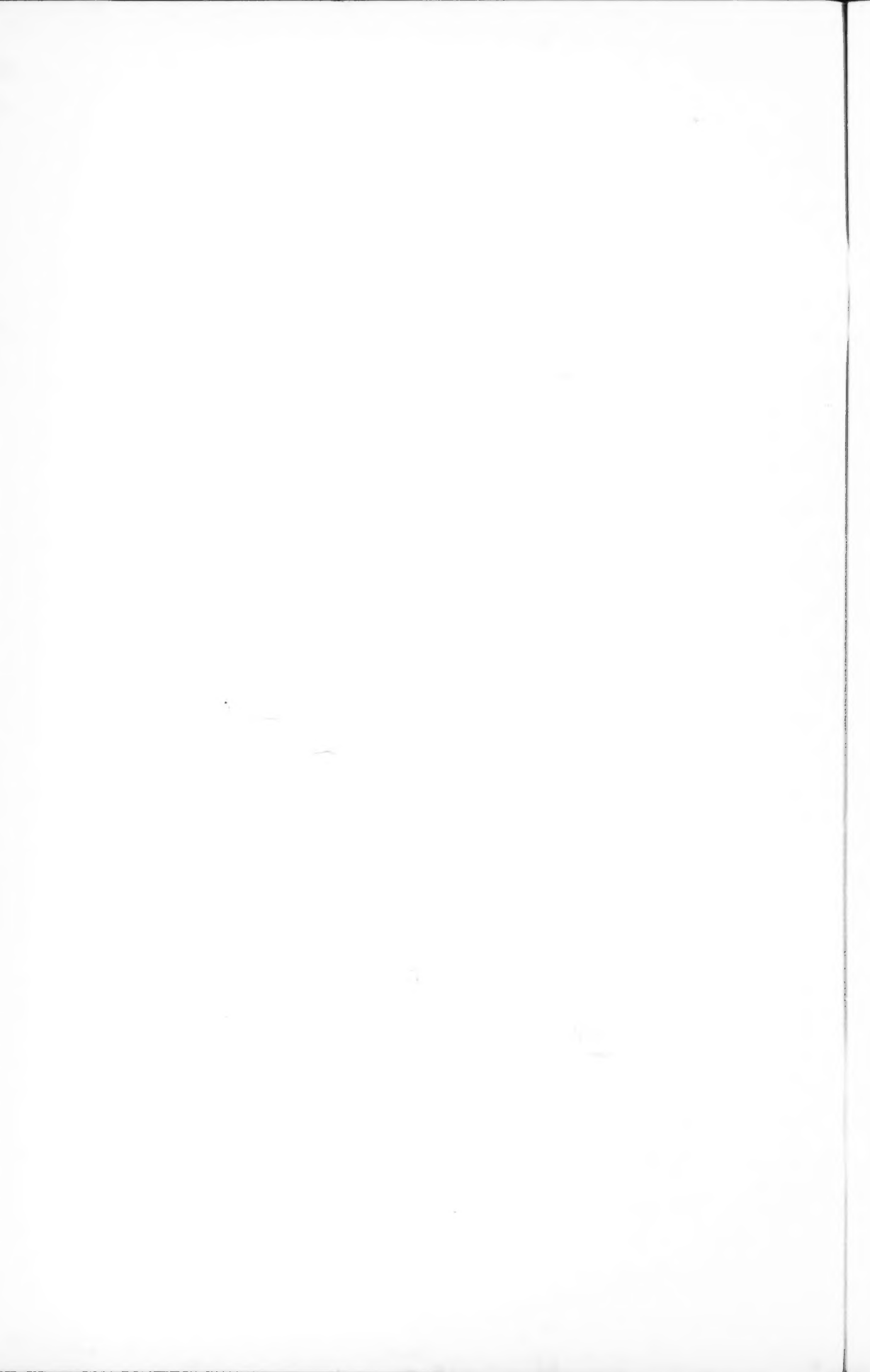
	<u>Page(s)</u>
<i>American Tobacco Co. v. Patterson</i> , 456 U.S. 63 (1982)	11
<i>Consumer Product Safety Comm'n v. GTE Syl- vania, Inc.</i> , 447 U.S. 102 (1980)	11
<i>In Re Braniff Airways, Inc.</i> , 700 F.2d 935 (5th Cir. 1983)	5, 6, 7, 8, 9
<i>In Re The Lionel Corporation</i> , 722 F.2d 1063 (2d Cir. 1983)	5, 7, 8, 9
<i>North Dakota v. United States</i> , 460 U.S. 300 (1983)	11
<i>Protective Committee for Independent Stock- holders of TMT Trailer Ferry, Inc. v. Anderson</i> , 390 U.S. 414 (1968)	8, 13, 14

Statutes

11 U.S.C. § 363(b)	7, F-1
11 U.S.C. § 510(b)	10, 11, F-1
11 U.S.C. § 541(b)	10, F-1
11 U.S.C. § 702	9, F-1
11 U.S.C. § 726	9, F-2
11 U.S.C. § 727	9, F-4
11 U.S.C. § 1125	6, 7, F-7
11 U.S.C. § 1126	6, 7, F-8
11 U.S.C. § 1129	7, F-10
28 U.S.C. § 1254(1)	2

Miscellaneous

	<u>Page</u>
H.R. Rep. No. 595, 95th Cong., 2d Sess. 194-96, reprinted in 1978 U.S. Code Cong. & Admin. News 1978, p. 6155	12
Slain and Kripke, <i>The Interface Between Securities Regulation and Bankruptcy—Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors</i> , 48 N.Y.U. L. Rev. 261 (1973)	12



No. _____

IN THE
Supreme Court of the United States
October Term, 1984

IN RE FLIGHT TRANSPORTATION
CORPORATION SECURITIES LITIGATION.

REAVIS & McGRATH, a partnership,
Petitioner,
v.
FRANK P. ANTINORE, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Reavis & McGrath respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The Eighth Circuit's opinion is reported at 730 F.2d 1128 and is set forth in Appendix A. The Eighth Circuit's denial of rehearing en banc is not reported and is set forth in Appendix B. The district court's orders are not reported and are set forth in Appendices C, D, and E.

JURISDICTION

On March 26, 1984, the Eighth Circuit entered judgment. On May 25, 1984, the Eighth Circuit denied Reavis & McGrath's petition for rehearing and suggestion of rehearing en banc. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The relevant provisions of the Bankruptcy Act and Bankruptcy Reform Act of 1978, 11 U.S.C. § 101 et seq., are set forth in Appendix F.

STATEMENT

Flight Transportation Corporation, ("FTC"), a Minnesota corporation, offered securities to the public in June 1982. Petitioner Reavis & McGrath served as counsel for the underwriters of the offerings. On June 10 and 14, 1982, Drexel Burnham Lambert Incorporated and Moseley, Hallgarten, Estabrook & Weeden ("Drexel-Moseley"), the co-lead underwriters, delivered to FTC certified checks totaling over \$24 million in full payment for the offerings. FTC deposited these checks in its account at a New Jersey bank.

On June 18, 1982, the Securities and Exchange Commission ("SEC") halted trading in FTC's stock and brought an injunctive action in the United States District Court for the District of Minnesota against FTC and its principal officers. The suit alleged

violations of the antifraud provisions of the federal securities laws. The district court immediately granted the SEC's motion to freeze FTC's assets and appointed a receiver to assume control of FTC. (Pretrial Orders Nos. 1, 4.) The district court ordered the receiver to place the proceeds of the offerings into a segregated account. (Pretrial Order No. 5.) On June 22, 1982, the receiver transferred approximately \$22,700,000 into a segregated, interest-bearing account in a Minneapolis bank (the "Escrow Fund") where it has remained. (Affidavit of Receiver James Rubenstein, August 4, 1982, at 1.) The segregated account has earned interest and, according to the receiver's most recent report, totals \$24.8 million.

In August 1982, Drexel-Moseley moved for a preliminary injunction to impose a constructive trust on the Escrow Fund on behalf of members of the public who had purchased in the June 1982 offerings and to enjoin the distribution, commingling, withdrawal, or other disposition of the Escrow Fund. The SEC filed a memorandum supporting Drexel-Moseley's motion for a constructive trust. FTC's general creditors and pre-June 1982 purchasers of FTC securities opposed the motion. The district court never formally ruled on the motion. If the motion had been granted, the entire Escrow Fund would not have become part of the bankruptcy estate and would have been awarded to the June 1982 purchasers.

On April 15, 1983, while the constructive trust motion was pending, representatives of FTC's general creditors, the June 1982 purchasers of FTC securities, and pre-1982 purchasers of FTC securities entered into the "Sharing Agreement," which provides that the first \$25 million recovered in this litigation, including the Escrow Fund, will be distributed as follows: \$12.25 million to the June 1982 purchasers, \$11 million to FTC's general creditors, \$1.0 million to the pre-June 1982 purchasers, and \$750,000 to an attorneys' "expense fund." Thus, the June 1982

purchasers would receive \$12,750,000 less under the Sharing Agreement than they would receive if a constructive trust were imposed.

On June 29, 1982, a petition for reorganization was filed under Chapter 11 of the Bankruptcy Reform Act. On May 18, 1983, the bankruptcy court directed that FTC be declared a bankrupt. On May 27, 1983, Drexel-Moseley moved the district court for summary judgment on its constructive trust claim and for certification of a constructive trust beneficiary class. The district court never ruled upon these motions. On July 20, 1983, the district court approved the Sharing Agreement.

The Court of Appeals Proceedings

On March 26, 1984, the Eighth Circuit affirmed the judgment of the district court in part and vacated in part. First, the court of appeals ruled that the Sharing Agreement did not amount to a de facto plan for the reorganization of FTC, but instead could be treated as a class action settlement. The Eighth Circuit, therefore, allowed the parties to the Sharing Agreement to dispose of more than 80% of the net assets of FTC's estate without following the express requirements of Chapter 11. (App. A, *infra*, A-12). Next, the court of appeals held that the substantive terms of the Sharing Agreement were fair because "a substantial question" existed concerning who is entitled to the Escrow Fund. In reaching this conclusion, the Eighth Circuit relied upon the theories advanced in a law review article, which in turn was cited in a House Report, to conclude that Section 510(b) of the Bankruptcy Reform Act might justify including the \$24.8 million in the bankruptcy estate despite the assertion of a claim that the funds were subject to a constructive trust. (App. A, *infra*, A-15-A-19). Finally, the court of appeals held that the Sharing Agreement, which had been negotiated by some but not all of the parties, could not exclude certain defendants from participating in FTC's recoveries.

Reavis & McGrath petitioned the Eighth Circuit for a rehearing en banc on April 19, 1984. The court of appeals denied Reavis & McGrath's petition on May 25, 1984.

REASONS FOR GRANTING THE WRIT

I.

THE EIGHTH CIRCUIT'S DECISION, WHICH PERMITS THE PARTIES TO THE SHARING AGREEMENT TO DISPOSE OF MORE THAN 80% OF THE ASSETS OF FTC'S ESTATE WITHOUT COMPLYING WITH THE EXPRESS REQUIREMENTS OF CHAPTER 11, DIRECTLY CONFLICTS WITH PRIOR DECISIONS OF THE SECOND AND FIFTH CIRCUITS.

This petition raises substantial issues concerning the procedures that may be used in complex bankruptcy litigation. The Eighth Circuit held that the parties to the Sharing Agreement could dispose of more than 80% of the net assets of FTC's estate without following the express requirements of Chapter 11. The Eighth Circuit's decision directly conflicts with the Second Circuit's decision in *In Re The Lionel Corporation*, 722 F.2d 1063 (2d Cir. 1983), and the Fifth Circuit's decision in *In Re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983), both of which held that the express requirements of Chapter 11 must be followed whenever the estate seeks to dispose of an important asset. The Eighth Circuit's decision, if permitted to stand, would eviscerate the procedural and substantive protections of Chapter 11.

FTC currently is the subject of a Chapter 11 proceeding. According to the most recent report of FTC's receiver, the \$24.8 million cash Escrow Fund is by far the largest asset and appears

to constitute more than 80% of the entire net value of the estate.¹ Before any such significant disposition of an asset of the estate can take place, Chapter 11 requires the parties and the court to comply with express statutory procedures, such as the disclosure requirements of Section 1125 and the voting provisions of Section 1126. 11 U.S.C. §§ 1125, 1126 (1982). None of these procedures was followed. Instead, the parties described the disposition of \$24.8 million from the estate as a "settlement," purported to follow the procedures under Federal Rule of Civil Procedure 23(e) for settling a class action, and thereby claimed to avoid the express statutory requirements of Chapter 11.

By looking past these euphemistic labels, it is apparent that the so-called "settlement" and "Sharing Agreement" is really a private plan of distribution that drains from the estate 80% of its net value and almost all of its cash. This is precisely the type of evasion that the Second and Fifth Circuits have refused to permit. In *In Re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983), Braniff Airways entered into a proposed transaction with PSA. The transaction provided for Braniff to transfer cash, airplanes, equipment, terminal leases, and landing slots to PSA in return for travel scrip, unsecured notes, and a profit participation in PSA's proposed operation. Recognizing that the economic realities of the proposed PSA transaction amounted to a de facto reorganization plan, the Fifth Circuit invalidated the agreement, because it "had the practical effect of dictating some of the terms of any

¹FTC's estate also includes \$1.6 million in cash other than the Escrow Fund. Although the precise values of the non-cash assets cannot be determined without more detailed information from the receiver, the remaining assets consist of: Flying Cloud Airport, which has an appraised value of \$1.8 million, but which is subject to a \$350,000 lien and an equitable mortgage; Cayman properties, which the receiver estimates have a potential net value of \$950,000; one airplane, whose title is disputed; and claims against certain insurance policies, banks, and other persons. Even assuming that these non-cash assets have an aggregate net value of \$4.6 million, the Escrow Fund would represent 80% of the entire estate.

future reorganization plan" and would "short-circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets." 700 F.2d at 940.

The trustee in *Braniff* had attempted to substitute a Section 363(b) hearing for the more demanding procedures required to approve a reorganization plan. Because of the significant impact of the proposed PSA transaction, the Fifth Circuit refused to allow the Section 363(b) hearing to replace the requirements of Chapter 11 for confirmation of a reorganization plan.² The Fifth Circuit admonished the parties:

In any future attempts to specify the terms whereby a reorganization plan is to be adopted, the parties and the district court must scale the hurdles erected in Chapter 11. See e.g. 11 U.S.C. § 1125 (disclosure requirements); *id.* § 1126 (voting); *id.* § 1129(a)(7) (best interest of creditors test); *id.* § 1129(b)(2)(B) (absolute priority rule). Were this transaction approved, and considering the properties proposed to be transferred, little would remain save fixed based equipment and little prospect or occasion for further reorganization. These considerations reinforce our view that this is in fact a reorganization.

700 F.2d at 940.

The Second Circuit reached the same conclusion in *In Re The Lionel Corporation*, 722 F.2d 1063 (2d Cir. 1983). In *Lionel*, the

²A trustee can use, sell, or lease property of the estate in the ordinary course of business without notice or a hearing. However, if the trustee wants to use, sell, or lease property of the estate, other than in the ordinary course of business, Section 363(b) requires notice and a hearing. Section 363(b), therefore, imposes a greater burden on the trustee when he is acting other than in the ordinary course of business. When the trustee also seeks to engage in transactions that are of such significance that they have the practical effect of dictating some of the terms of any future reorganization plan, the trustee must comply with more than the notice and hearing requirements of Section 363(b); the trustee must comply with the express requirements of Chapter 11 for plans of reorganization.

Second Circuit reversed the order of a bankruptcy judge authorizing the sale by the debtor of its 82% common stock holding in another corporation. The Second Circuit concluded that the disposition "of an important asset" required the bankruptcy court to comply with the requirements of Chapter 11. Like the Fifth Circuit in *Braniff*, the Second Circuit refused to allow the lower court to resolve the matter with a more limited Section 363(b) hearing. In rejecting the debtor's argument that Chapter 11 proceedings would be unduly lengthy, the Second Circuit explained:

As the Supreme Court has noted, it is easy to sympathize with the desire of a bankruptcy court to expedite bankruptcy reorganization proceedings for they are frequently protracted. "The need for expedition, however, is not a justification for abandoning proper standards." *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 450 (1968). Thus, the approval of the sale of Lionel's 82 percent interest in Dale was an abuse of the trial court's discretion.

722 F.2d at 1071.

The Sharing Agreement is clearly invalid under the holdings of *Lionel* and *Braniff* because it purports to distribute the most significant assets of FTC's estate without complying with the express requirements of Chapter 11. The Eighth Circuit attempted to distinguish *Braniff* by relying on the provision of the Sharing Agreement which returns a portion of the funds to the estate for later distribution. The Eighth Circuit stated:

[T]he Sharing Agreement, unlike the *Braniff* Agreement, does not dictate the terms of any future reorganization plan, since the assets of the bankruptcy estate will be distributed in the normal course of the bankruptcy proceeding. . . .

(App. A, *infra*, A-13-A-14). The Eighth Circuit's distinction is incorrect because, while it may be true that whatever assets

remain in FTC's estate will be distributed in a later bankruptcy proceeding, the Eighth Circuit has ignored the plain fact that the Sharing Agreement directly affects which assets comprise the FTC estate. In *Lionel*, a portion of the assets also remained for distribution in bankruptcy, but the Second Circuit refused to short-circuit the Chapter 11 procedures. In both *Lionel* and *Braniff*, the Second and Fifth Circuits recognized that whenever a significant asset is removed from the estate, the express requirements of Chapter 11 must be followed.

The Eighth Circuit also asserted without explanation that the failure to comply with the express procedures of Chapter 11 did not prejudice Reavis & McGrath because those procedures would not afford Reavis & McGrath any greater protection than the procedures followed by the district court. (App. A, *infra*, A-13). However, Congress, not the Eighth Circuit, has determined what procedures should be followed and what protections are necessary.³

The Eighth Circuit has misconceived the nature of the proceedings required by Chapter 11. The Sharing Agreement is invalid under the law applied in the Second and Fifth Circuits. This

³To bolster its argument, the Eighth Circuit assumed that FTC would be liquidated rather than reorganized. (App. A, *infra*, A-13). The Eighth Circuit's assumption that FTC should be liquidated rather than reorganized has no basis in the record. On June 29, 1982, a petition for reorganization was filed under Chapter 11 of the Bankruptcy Reform Act and on May 18, 1983, the bankruptcy court directed that FTC be declared a bankrupt. No party ever has moved to convert this Chapter 11 reorganization proceeding into a liquidation. If such a motion were advanced, the parties should have the opportunity to address the merits of the proposed conversion. It was inappropriate for the Eighth Circuit to assume *sua sponte* that FTC should be liquidated. Even assuming *arguendo* that FTC were to be liquidated pursuant to Chapter 7, the district court failed to comply with express provisions governing liquidations, such as Section 702 (requiring the election of a trustee), Section 726 (adherence to a schedule of distribution), and Section 727 (prohibiting the debtor's discharge unless certain conditions are met). 11 U.S.C. §§ 702, 726, 727 (1982).

Court should review the decision of the Eighth Circuit to harmonize the law among the courts of appeals and to insure that the lower courts comply with the express requirements that Congress has established in Chapter 11.

II.

THE EIGHTH CIRCUIT FAILED TO GIVE EFFECT TO THE UNAMBIGUOUS MEANING OF THE WORDS USED IN SECTION 510(b).

The Eighth Circuit concluded that, despite its significant effect upon FTC's estate, the Sharing Agreement should be treated as an ordinary settlement. The Eighth Circuit, therefore, reviewed the Sharing Agreement to determine its fairness. The persons who purchased FTC's securities in the 1982 public offerings had claimed that virtually all of the Escrow Fund belonged to them because the funds were subject to a constructive trust. The creditors had disputed this claim and had argued that all of the Escrow Fund should remain in FTC's estate. The Sharing Agreement provided that the \$24.8 million would be divided between these groups, according to various formulas, and that a portion of the funds would be set aside as a "war chest" to fund existing and contemplated litigation.

In reviewing these conflicting claims, the Eighth Circuit acknowledged the general rule that property obtained by fraud of the bankrupt cannot properly be included in the assets of the bankrupt's estate. (App. A, *infra*, A-16). Thus, property subject to a constructive trust claim never becomes "property of the estate," as that term is used in Section 541 of the Bankruptcy Act, 11 U.S.C. § 541 (1982). Accordingly, under well-settled principles, the purchasers of FTC's securities in the 1982 public offerings would receive the \$24.8 million in the Escrow Fund. The Eighth Circuit, however, concluded that Section 510(b) created

“a substantial question” concerning the application of the doctrine of constructive trust in connection with a claim for damages by purchasers of securities of the debtor. (App. A, *infra*, A-18). That conclusion conflicts with the ordinary meaning of the words used in Section 510(b). Section 510(b) provides:

Any claim for rescission of a purchase or sale of a security of the debtor or of an affiliate or for damages arising from the purchase or sale of such a security shall be subordinated *for purposes of distribution* to all claims and interests that are senior or equal to the claim or interest represented by such security. (Emphasis supplied.)

The language of Section 510(b) is clear and unambiguous. It deals only with the relative priorities to be recognized upon distribution between competing claims asserted by security holders and general unsecured creditors against assets included in the bankrupt estate. Section 510(b) does not purport to address the question of what property is included within the bankrupt estate. The statute, by its own terms, is therefore inapposite to the issue presented here.

This Court has held that the ordinary meaning of the words in a statute is conclusive, absent a clearly expressed legislative intention to the contrary. *North Dakota v. United States*, 460 U.S. 300 (1983); *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982); *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). In this case, the express language of the statute is not ambiguous.

Instead of regarding the unambiguous language of the statute as controlling, the Eighth Circuit relied upon a law review article, which had been cited by a House Report, to conclude that Congress may have intended Section 510(b) to foreclose constructive trust claims by defrauded shareholders. The court concluded that the asset that is subject to the constructive trust would remain in the estate, notwithstanding the provisions of Sec-

tion 541, and the priority of claims to the estate would be governed by Section 510(b). Thus, under the court's reasoning, the defrauded shareholders' claims would not take priority over general unsecured creditors. (App. A, *infra*, A-17), citing Slain and Kripke, *The Interface Between Securities Regulation and Bankruptcy—Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors*, 48 N.Y.U. L. Rev. 261 (1973), and H.R. Rep. No. 595, 95th Cong., 2d Sess. 194-96, *reprinted in* 1978 U.S. Code Cong. & Admin. News 1978, p. 6155.

The theory advanced by Messrs. Slain and Kripke is contrary to the plain meaning of Section 510(b). Moreover, the Eighth Circuit's recourse to a law review article cited in a House Report represents an unnecessarily circuitous path to determining congressional intent. Faced with the express and unambiguous language of the statute, the Eighth Circuit erred in concluding that the beneficiaries of the trust should forfeit half of their entitlement because some court, some day might embrace the theories in a law review article, and expand those theories to transform a section in the Bankruptcy Reform Act dealing with distribution into a section that dictates what property comes within the bankrupt's estate.

The ordinary meaning of the words used in Section 510(b) should be conclusive. The holding of the Eighth Circuit conflicts with this Court's directive that legislative history should not be considered where the language of the statute is clear. The ruling below also abrogates the important equitable principles underlying the doctrine of constructive trusts. This Court should grant certiorari to make clear that the rights of defrauded shareholders who have a valid constructive trust claim cannot be abrogated by Section 510(b).

III.

THE DISTRICT COURT ABDICATED ITS RESPONSIBILITY TO PREPARE FINDINGS OF FACT AND CONCLUSIONS OF LAW SETTING FORTH THE BASES FOR ITS DECISION TO APPROVE THE SHARING AGREEMENT.

The district court did not prepare findings of fact or conclusions of law explaining why it approved the Sharing Agreement. Consequently, the Eighth Circuit was forced to evaluate the fairness of the purported settlement on the basis of the limited record before it without the benefit of findings or conclusions by the district court. The Eighth Circuit acknowledged that its "review is made more difficult because the District Court did not write an opinion explaining why it deemed the Sharing Agreement to be fair, reasonable, and adequate." (App. A, *infra*, A-14-A-15). Since the district court did not receive any evidence at the purported fairness hearing, did not prepare any findings or conclusions, and did not write any opinion, no one, including the Eighth Circuit, has any way of knowing what law the district court applied or on what facts the district court relied.

In *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414 (1968), this Court admonished that "[i]t is essential . . . that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler-plate approval phrased in appropriate language but unsupported by an evaluation of the facts or analysis of the law." 390 U.S. at 434. The court below acknowledged that *Anderson* generally forbids district courts from proceeding by fiat and without explanation, but felt that this Court would permit a reviewing court to uphold a district court's action if the record contained adequate facts to support the district court's decision. (App. A, *infra*, A-15), citing *Anderson*, 390 U.S. at 437. In *Anderson*, however, this Court analyzed

specific references to a factual record and concluded that the facts were insufficient to support the district court's decision. *Anderson*, 390 U.S. at 437-40 and n.19. In this case, there is no factual record.

In the context of a class action, where absent class members should receive the added protection of an independent review by the district court, the procedures of entering findings and conclusions are all the more important. Where, as here, the district court fails to fulfill its obligations, a court of appeals should insist that the district court follow established procedures.

CONCLUSION

For the reasons set forth above, Reavis & McGrath respectfully urges that this petition for a writ of certiorari should be granted.

Respectfully submitted,

Jerold S. Solovy

Joan M. Hall

JENNER & BLOCK

One IBM Plaza

Chicago, Illinois 60611

(312) 222-9350

Attorneys for Petitioner

Reavis & McGrath

July 24, 1984



TABLE OF APPENDICES

Appendix A	Judgment of the United States Court of Appeals for the Eighth Circuit (March 26, 1984), published at 730 F.2d 1128 (8th Cir. 1984).
Appendix B	Order of the United States Court of Appeals for the Eighth Circuit Denying Petition for Rehearing and Suggestion of Rehearing en Banc (May 25, 1984).
Appendix C	Memorandum and Order of the United States District Court for the District of Minnesota Granting Plaintiff Class Certification (July 20, 1983).
Appendix D	Order of the United States District Court for the District of Minnesota Approving the Sharing Agreement As A Settlement Pursuant to Federal Rules of Civil Procedure 23(e) (July 20, 1983).
Appendix E	Order of the United States District Court for the District of Minnesota Authorizing Debtor-in-Possession to Become a Party to Sharing Agreement (July 22, 1983).
Appendix F	Relevant Provisions of the Bankruptcy Act and Bankruptcy Reform Act of 1978.

APPENDIX A



United States Court of Appeals

FOR THE EIGHTH CIRCUIT

Nos. 83-2021, 83-2114, 83-2115, 83-2121

No. 83-2021

In Re Flight Transportation Corporation
Securities Litigation

Drexel Burnham Lambert Incorporated and
Moseley, Hallgarten, Estabrook & Weeden,
Inc., on behalf of themselves and all others
similarly situated,

Appellants,

v.

Flight Transportation Corporation, FTC
Executive Air Charter, Inc., FTC Cayman,
Ltd., and William Rubin,

Appellees,

Putnam High Yield Trust, United High Income
Fund, Inc., Oppenheimer High Yield Fund;
Continental Illinois Nat'l Bank & Trust Co. of
Chicago, Greyhound Leasing, & Norwest Bank
Minneapolis, N.A., Norwest Bank Calhoun-
Isles, N.A., and named plaintiffs in the action of
Frank P. Antinore, et al.,

Intervenors.

On Appeal
from the
United States
District
Court for the
District of
Minnesota.

No. 83-2114

In Re Flight Transportation Corporation
Securities Litigation

Fox & Company,

Appellant.

No. 83-2115

In Re Flight Transportation Corporation
Securities Litigation

Jack Adams, Jr., Ezell Jones, Russell T. Lund,
Jr., Wardwell M. Montgomery, Delbert
Oldenburg, Marjorie Terhaar, Larry Walston,
Walston Wings, Inc., Lunds, Inc., and Edward
Brunner,

Appellants.

No. 83-2121

In Re Flight Transportation Corporation
Securities Litigation

Reavis & McGrath,

Appellant.

Submitted: October 11, 1983

Filed: March 26, 1984

Before LAY, Chief Judge, HENLEY, Senior Circuit Judge, and
ARNOLD, Circuit Judge.

ARNOLD, Circuit Judge.

This appeal presents the question whether the District Court abused its discretion in approving a "settlement" among claimants in a massive securities-fraud case that has been further complicated by a bankruptcy. We affirm in the main, vacate with respect to one aspect of the settlement, and remand for further proceedings.

I.

A.

Flight Transportation Corporation (FTC), a Minnesota corporation, and its subsidiary corporations provided air-charter and other general-aviation services. William Rubin was FTC's President, Chairman of the Board, and chief executive officer.

In June 1982 FTC made two public offerings of securities. On June 3, 1982, FTC sold 715,000 shares of common stock and, on June 4, 1982, 25,000 "units" of securities, each unit consisting of a debenture and a number of stock warrants. Drexel Burnham Lambert Incorporated and Moseley, Hallgarten, Estabrook & Weeden (Drexel-Moseley) were the lead underwriters, and, on June 10 and June 14, 1982, they delivered certified checks totaling over \$24 million to FTC in full payment for the two offerings.¹ FTC deposited these checks in its account at a New Jersey bank.

¹Drexel-Moseley paid FTC \$6,309,875 for the 715,000 shares of common stock and \$18,001,562.50 for the 25,000 "units."

A few days later, on June 18, 1982, the SEC halted trading in FTC securities and commenced an action against FTC, its subsidiaries, and Rubin in the United States District Court for the District of Minnesota, alleging that the defendants had violated several provisions, especially the antifraud provisions, of the federal securities laws.² The SEC sought an injunction against further violations, appointment of a receiver, an accounting, and an order of disgorgement so that, apparently, restitution might be made to defrauded investors. See *SEC v. Flight Transportation Corp.*, 699 F.2d 943, 945 & n.2 (8th Cir. 1983). The District Court entered a temporary restraining order and appointed a receiver, who caused some \$22.7 million, the remaining proceeds of the June 3 and 4, 1982, offerings, to be transferred from FTC's account in the New Jersey bank to a segregated, interest-bearing account in a Minneapolis bank (the Escrow Fund).³

Then, on June 23, 1982, Drexel-Moseley filed a class action in the same district court on behalf of themselves and all other persons who had purchased FTC securities pursuant to the June 3 and June 4 offerings.⁴ In August 1982 Drexel-Moseley moved for a constructive trust on the Escrow Fund on behalf of members of the public to whom they had sold the June 1982 securities and sought a preliminary injunction against the distribution, commingling, withdrawal, or other disposition of the Escrow Fund. The District Court has never explicitly ruled on this motion.

²For example, the SEC alleged that on registration statements, prospectuses, and other documents the defendants had overstated gross revenues, miles flown, and number of helicopter and charter flights; that Rubin and others had engaged in a check-kiting scheme; and that Rubin had misapplied FTC funds.

³The fund now exceeds \$25 million, including accrued interest.

⁴Drexel-Moseley and other members of the underwriting syndicate bought all of the securities in the June 1982 offerings pursuant to their agreement with FTC, Joint Appendix (Jt. App.) 55-58, and then resold most of them to the investing public. Drexel-Moseley still own about \$300,000 worth of the June 1982 securities.

During the following months, the litigation became increasingly complex. A number of separate individual and class actions were filed against FTC, its subsidiaries, its officers and directors, its accountants, and its underwriters. Certain defendants cross-claimed for indemnity, and some of FTC's directors brought suits for damages directly against FTC. On October 8, 1982, about 22 cases were consolidated when a class-action complaint was filed on behalf of all persons who purchased FTC securities between November 30, 1979, and June 18, 1982. *Antinore v. Flight Transportation Corp.*, Master Docket No. 4-082-874 (D. Minn. 1982), Jt. App. 693. Moreover, on June 29, 1982, several major creditors filed an involuntary Chapter 11 bankruptcy petition against FTC in the Bankruptcy Court for the District of Minnesota. When the District Court stayed the bankruptcy as well as all other proceedings against the defendants, several appeals to this Court ensued. We directed that the bankruptcy action be allowed to proceed, *SEC v. Flight Transportation Corp.*, 693 F.2d 66 (8th Cir. 1982) (per curiam); *SEC v. Flight Transportation Corp.*, Nos. 82-1964, -1990 (8th Cir. Mar. 8, 1983) (order dismissing appeals), and that one of FTC's creditors and William Rubin's wife be allowed to intervene in the SEC action in the District Court, *SEC v. Flight Transportation Corp.*, 699 F.2d 943 (8th Cir. 1983). We left open the other major issue on appeal, that of whether the District Court or the Bankruptcy Court should decide the constructive-trust and disgorgement claims, noting that the issue could be addressed in the lower courts and thereafter reviewed on appeal if necessary. *SEC v. Flight Transportation Corp.*, Nos. 82-1964, -1990 (8th Cir. Mar. 8, 1983) (order dismissing appeals).

Meanwhile, representatives of persons who had purchased FTC securities and certain business creditors of FTC began negotiating in order to resolve their competing claims to the Escrow Fund. On April 15, 1983, they entered into the "Sharing Agreement" which is the subject of this appeal.

On May 18, 1983, the Bankruptcy Court directed that FTC be declared a bankrupt. Subsequently, Judge Charles R. Weiner,⁵ who had previously been designated by the Judicial Panel on Multidistrict Litigation to sit as the District Judge in this litigation, was also designated to sit as the Bankruptcy Judge. On May 27, 1983, Drexel-Moseley moved the District Court for summary judgment on its constructive-trust claim and for certification of a constructive-trust-beneficiary class.

On June 27, 1983, Judge Weiner held a hearing to consider the Sharing Agreement. Various parties argued the merits of the Sharing Agreement and the constructive-trust claim, among other matters. About three weeks later, Judge Weiner entered the three orders from which these appeals are taken. The first order, Pretrial Order No. 153, certifies as a class all persons who purchased FTC securities between 1979 and 1982, and suffered a loss from such purchase, with the exception of officers and directors of FTC and related companies, other defendants named in the FTC or related actions, and any other person found guilty of wrongdoing in the FTC action or related actions. The class is divided into five subclasses: (1) purchasers of FTC common stock pursuant to a registration statement dated November 30, 1979; (2) purchasers of units of securities of FTC including common stock and warrants, issued pursuant to a registration statement dated March 2, 1981; (3) purchasers of FTC common stock pursuant to a registration statement dated June 3, 1982; (4) purchasers of FTC units consisting of debentures and stock warrants, pursuant to a registration statement dated June 4, 1982; and (5) all class members not included in any of the four preceding subclasses.

The second order entered by the District Court, Pretrial Order No. 154, approved the Sharing Agreement. The court found that the Sharing Agreement was fair, adequate, and reasonable, and

⁵United States District Judge for the Eastern District of Pennsylvania, sitting by designation in the District of Minnesota.

directed the parties to place it into effect. The third order was entered by Judge Weiner in his capacity as bankruptcy judge, and it authorizes Thomas C. Bartsh, previously appointed as receiver of FTC by the District Court, and later also appointed by the Bankruptcy Court as debtor-in-possession of FTC's bankrupt estate, to become a party to the Sharing Agreement, to bind the estate to the Agreement, and to transfer or assign claims of the estate as necessary to comply with the Sharing Agreement.

Drexel-Moseley (the underwriters) appeal all three orders. The remaining appellants—Fox & Company (FTC's auditor), Reavis & McGrath (the underwriters' lawyers), and a group of "outside" directors of FTC (the Adams Group)—appeal the latter two orders.

B.

Under the Sharing Agreement, persons, including the receiver and the bankruptcy estate, who have claims against FTC or other defendants agree to prosecute their claims jointly, to pool their recoveries, whether from the Escrow Fund, other assets of FTC, or damage actions against any of the defendants, and to disburse the money among themselves in accordance with an agreed-upon schedule. Defendants, defined as "[a]ny PERSON against whom any CLAIMANT has any claim for a monetary recovery arising out of or related to the CLAIMANT's claim against FTC," Jt. App. 360, are excluded from the Sharing Agreement.

The Agreement provides that, first, the pooled recoveries will be divided between creditors and securities claimants. The securities claimants, also known as the "class plaintiffs," are divided into subclasses in accordance with Pretrial Order No. 153. The pooled

recoveries are allocated according to the following schedule, set out in paragraph "O" of the Sharing Agreement:

- (1) The initial \$25,000,000 of TOTAL RECOVERIES shall be allocated as follows:

CREDITORS	\$11,000,000
SUBCLASS I and II	500,000
SUBCLASS III	1,250,000
SUBCLASS IV	11,000,000
SUBCLASS V	500,000
EXPENSE FUND	750,000

- (2) The next \$5,000,000 of TOTAL RECOVERIES shall be allocated as follows:

CREDITORS	\$1,500,000
SUBCLASS I and II	500,000
SUBCLASS III	1,000,000
SUBCLASS IV	1,500,000
SUBCLASS V	500,000

- (3) The next \$5,000,000 of TOTAL RECOVERIES shall be allocated as follows:

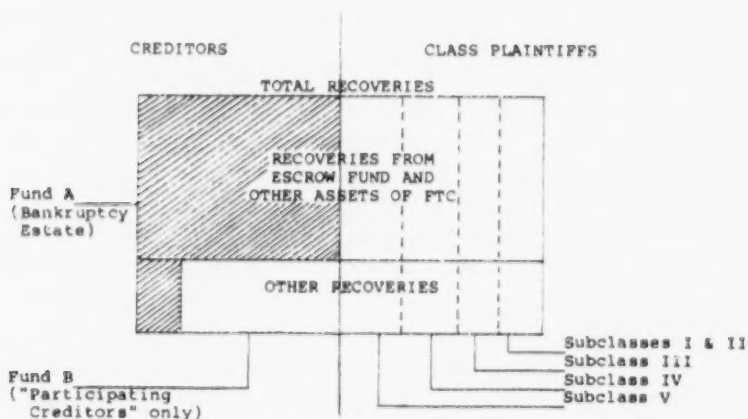
CREDITORS	\$1,800,000
SUBCLASS I and II	-0-
SUBCLASS III	500,000
SUBCLASS IV	2,700,000
SUBCLASS V	-0-

Jt. App. 379. The class plaintiffs agree not to assert any claim against funds allocated to creditors. Jt. App. 370.

Next, the source of each recovery in the creditors' allocation is identified, and the creditors' allocation is suballocated into two funds. Fund A, which becomes the bankruptcy estate, consists of all recoveries from the creditors' part of the "ESCROW FUND or Assets of FTC (except to the extent that an Asset of FTC consists of a claim against present or former officers, directors, accountants or attorneys of FTC, or underwriters of FTC securities

...)” plus five per cent. of all other recoveries. Fund B consists of the remaining recoveries, *i.e.*, 95 per cent. of the recoveries from sources other than the Escrow Fund or FTC’s assets. Thus, Fund B is comprised of the creditors’, class plaintiffs’, and FTC’s recoveries from defendants other than FTC: the officers and directors, underwriters, accountants, lawyers, and so forth. These defendants cannot participate in Fund B (which is available only to “Participating Creditors,” defined so as to exclude these defendants), although they are free to make claims against the bankruptcy estate (which consists of Fund A).

The operation of the Sharing Agreement may be illustrated by a simplified diagram, which does not purport to be proportionately accurate:



II. JURISDICTION

The appellees argue that we do not have jurisdiction to hear these appeals because none of the orders appealed from is final. We disagree. Under 28 U.S.C.A. §1292(a)(1) (West Supp. 1983), we have jurisdiction of appeals from “[i]nterlocutory orders . . . refusing . . . injunctions. . . .” When an order has the practical effect of refusing an injunction, it is immediately ap-

pealable under §1292(a)(1) if it “might have a ‘serious, perhaps irreparable, consequence’ ” and “can be ‘effectually challenged’ only by immediate appeal.” *Carson v. American Brands, Inc.*, 450 U.S. 79, 84 (1981) (quoting *Baltimore Contractors, Inc. v. Bodinger*, 348 U.S. 176, 181 (1955)).

The District Court, by entering the orders which, taken together, both approve the Sharing Agreement and permit the parties to implement it, effectively denied Drexel-Moseley’s motion for a preliminary injunction to prohibit the commingling or disposition of the Escrow Fund, since the very purpose of the Sharing Agreement is to create and disburse a pooled fund consisting, in large part, of the Escrow Fund.⁶ Since claimants who receive distributions from the Escrow Fund would probably spend or otherwise dissipate them, Drexel-Moseley’s ability to trace the proceeds of the June 1982 offerings, a necessary element of their constructive-trust claim, see, e.g., Restatement of Restitution §215 (1937), would be impaired. And since the difficulties of tracing would become greater as time went on, Drexel-Moseley might not be able to obtain relief on appeal after a final order was entered. Thus, Drexel-Moseley has made a sufficient showing of the possibility of serious or irreparable harm, so that we have jurisdiction under §1292(a)(1).⁷

⁶Pretrial Order No. 153, which certified a class of securities purchasers and named class representatives, effectively denied Drexel-Moseley’s motion for certification of a constructive-trust-beneficiary class. Although orders denying class certification are ordinarily not immediately appealable, see, e.g., *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 467 (1978), an exception exists where the denial of class certification is interdependent with the remainder of the appealed order, see *In re Federal Skywalk Cases*, 680 F.2d 1175, 1180 (8th Cir. 1982), cert. denied, 103 S. Ct. 342 (1983). Here, we view the orders appealed from as, in effect, one order that approves the Sharing Agreement and directs the parties to implement it, and we shall consider it as an integrated whole.

⁷The appellees pointed out that, under the Sharing Agreement, the Escrow Fund may not be actually disbursed to claimants without the
(footnote continued on next page)

III. THE MERITS

A. CHARACTERIZATION OF THE SHARING AGREEMENT

The Adams Group and Reavis & McGrath argue that the Sharing Agreement is a de facto plan for the liquidating reorganization of FTC, approved without compliance with the requirements of the Bankruptcy Code.⁸ They assert that the Agreement contemplates the transfer of all the assets of the estate of FTC and its subsidiaries to third parties, followed by distribution of the liquidated proceeds of certain assets to specified parties. They also point out that the Agreement contains provisions designed to marshal, consolidate, administer, and distribute all of the FTC assets; contains voting procedures for certain groups of FTC claimants; provides for assignment of duties with respect to the continued prosecution and settlement of certain outstanding

(footnote continued from previous page)

lower court's approval, Jt. App. 378, 385. Nevertheless, we do not believe that the appellants are required to wait until the first order approving a disbursement is entered in order to appeal. The orders before us completely dispose of the substantive issue of who is entitled to share in the Escrow Fund; the mode of distribution set forth in the Sharing Agreement is irreconcilable with the constructive-trust theory. Actual disbursement will occur as soon as the lower court performs the relatively ministerial act of approving allocations recommended by the Claimants' Committee.

The appellees also argue that the appellants do not have standing to contest the approval of the Sharing Agreement, because they are not parties to the Agreement and because it does not affect their liability. We disagree. It is enough that the Sharing Agreement enlarges the appellants' exposure to possible liability, because the June 1982 securities purchasers may seek to recover from the appellants the difference between the amount the purchasers paid for the June 1982 securities and the amount they recover under the Sharing Agreement.

⁸The appellants assert that the District Court failed to comply with any of the statutory requirements regarding the contents of a reorganization plan, 11 U.S.C. §1123; the preparation of disclosure statements regarding such a plan, 11 U.S.C. §1125; the provisions for voting on the plan by all interested parties, 11 U.S.C. §1126; the standards for the court's confirmation of the plan, 11 U.S.C. §1129; and the appointment of a creditors' committee, 11 U.S.C. §1102(a)(1).

claims against FTC; and establishes bank accounts for the payment of certain fees and expenses and for the allocation of proceeds of recoveries against FTC to creditors and security holders.

We think the Sharing Agreement is more like a compromise or settlement than a plan of reorganization. The main thrust of the Agreement is to conclude the parties' controversy as to (1) whether the entire Escrow Fund is properly includible in the bankruptcy estate, subject to the claims of FTC's general creditors, who, under 11 U.S.C. §510(b), would have priority over the claims of security holders, or (2) whether no part of the Escrow Fund became property of the estate, but rather belonged entirely to the June 1982 purchasers by virtue of a constructive trust. The parties compromised by agreeing that part of the Escrow Fund would go to the bankruptcy estate and part would go to the security holders.⁹ The bankruptcy case will proceed according to regular bankruptcy procedure.

The Sharing Agreement also provides for a second level of allocation, between the bankruptcy estate (Fund A) and a fund (Fund B) available only to "Participating Creditors," *i.e.*, creditors who are not also defendants or potential defendants in FTC-related litigation. Part of Fund B contains recoveries from sources other than FTC's assets or the Escrow Fund, property which would not have been included in the bankruptcy estate in any event. While it is true that Fund B will also contain recoveries on any claims that FTC might have against its officers, directors, accountants, lawyers, and underwriters, we do not believe that this provision alone destroys the essential nature of the Sharing Agreement as a compromise or settlement.

⁹We assume, as do the parties, that the Escrow Fund will be among the first assets distributed under paragraph "O" of the Sharing Agreement.

It is also of some relevance that, although the bankruptcy case was brought under Chapter 11, the ultimate outcome of this litigation will be the liquidation of FTC, not its continued operation as a reorganized business.

A corporate reorganization is a continuing business affair requiring close supervision and affecting many interested parties. The success or failure of a reorganization may hinge upon the very compromise at issue. A liquidation bankruptcy is a terminal affair. The bankrupt's financial affairs are beyond repair. Liquidation is to be accomplished as rapidly as possible consistent with obtaining the best possible realization upon the available assets and without undue waste by needless or fruitless litigation.

In re Blair, 538 F.2d 849, 852 (8th Cir. 1976) (footnote omitted). The Adams Group and Reavis & McGrath, to the extent that they are creditors, are concerned not with ensuring the future profitable conduct of the business, but with the size of the bankrupt's estate and how it is to be divided. Thus, if the Sharing Agreement is in some sense a reorganization, it is not a typical one. The Adams Group presented their arguments on these points to Judge Weiner at the hearing held on June 27, 1983. While Reavis & McGrath did not receive notice of the hearing, the arguments that they make here were presented by other parties in attendance. Neither appellant explains why the procedural provisions of Chapter 11 regarding the formulation and approval of a plan would have afforded them significantly greater benefits than those they received. See also *In re Ericson*, 6 Bankr. 1002 (D. Minn. 1980).

In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983), cited by the appellants, is inapposite. Unlike the case before us, *Braniff* involved the question whether an agreement to transfer assets of the bankrupt was invalid under the "use, sale, or lease" provision of 11 U.S.C. §363(b). Moreover, the Sharing Agreement, unlike the *Braniff* agreement does not dictate the terms of any future

reorganization plan, since the assets of the bankruptcy estate will be distributed in the normal course of the bankruptcy proceeding; it does not require any claimant to vote in favor of any future reorganization plan; and the only release of claims involved is the class plaintiffs' release of their own claims against FTC's estate.

For these reasons, we hold that the Sharing Agreement is not invalid as a plan of reorganization approved in violation of the Bankruptcy Code, but rather is to be judged according to the principles governing approval of settlements and compromises.

B. STANDARD OF REVIEW

The approval of a settlement under Fed. R. Civ. P. 23(e) as fair, reasonable, and adequate "is committed to the sound discretion of the trial judge." *Grunin v. International House of Pancakes*, 513 F.2d 114, 123 (8th Cir.), *cert. denied*, 423 U.S. 864 (1975) (quoting *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 34 (3d Cir. 1971)). In exercising its discretion, the District Court must consider all factors bearing on the fairness of the settlement, including

- (a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.

Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1929). *Accord*, *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-25 (1968). *Drexel* and *Anderson* involve approval of settlement in bankruptcy cases, and the same standards apply to the approval of a class-action settlement under Rule 23(e). *Grunin, supra*, 513 F.2d at 124.

Our review is made more difficult because the District Court did not write an opinion explaining why it deemed the Sharing

Agreement to be fair, reasonable, and adequate. The Supreme Court has cautioned that, when reviewing the approval of a settlement,

[i]t is essential . . . that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law.

Anderson, supra, 390 U.S. at 434. Nonetheless, if

the record contained adequate facts to support the decision of the trial court to approve the proposed compromises, a reviewing court would be properly reluctant to attack that action solely because the court failed adequately to set forth its reasons or the evidence on which they were based.

Id. at 437. Here, the record reflects that the District Court had before it the information necessary to consider the fairness of the Sharing Agreement. All the arguments made before us were presented to the District Court. Accordingly, we shall review the District Court's action on the basis of the record before us.

C. STRENGTH OF THE CONSTRUCTIVE-TRUST CLAIM

Drexel-Moseley, Fox, and Reavis & McGrath¹⁰ argue that the Sharing Agreement is unfair to the June 1982 purchasers, that Drexel-Moseley's entitlement to a constructive trust on the Escrow Fund is so clear that Judge Weiner abused his discretion by approving a settlement that, in effect, bargained away almost half of it. They assert that the Escrow Fund never became "property of the estate" under 11 U.S.C §541 (1982), pointing to the principle that

¹⁰The Adams Group does not argue in favor of the constructive trust.

a Trustee in Bankruptcy can have no interest in property acquired by the fraud of a bankrupt, or anyone else, as against the claim of the rightful owner of such property.

* * *

Property obtained by fraud of the bankrupt, or by other tort, is not properly a part of the assets of a bankrupt's estate.

Nicklaus v. Bank of Russellville, 336 F.2d 144, 146, 147 (8th Cir. 1964); see also, e.g., *In re Teltronics, Ltd.*, 649 F.2d 1236, 1239 (7th Cir. 1981).

We agree that *Nicklaus* correctly states the general rule. Under §541(a)(1), the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." This principle is refined in §541(d):

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property . . . becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

Thus, where, under state law, the debtor's fraud or other wrongful conduct gives rise to a constructive trust, so that the debtor holds only bare legal title to the property, subject to a duty to reconvey it to the rightful owner, the estate will generally hold the property subject to the same restrictions. E.g., *In re Shepard*, 29 Bankr. 928, 931-32 (Bankr. M.D. Fla. 1983); 4 *Collier on Bankruptcy* ¶541.13 (15th ed. 1983).

The appellees argue, however, that where, as here, the constructive-trust claim is based on a security holder's allegation of

fraud, the general rule does not apply. They point to 11 U.S.C. §510(b) (1982), which provides:

Any claim for rescission [sic] of a purchase or sale of a security of the debtor or of an affiliate or for damages arising from the purchase or sale of such a security shall be subordinated for purposes of distribution to all claims that are senior or equal to the claim or interest represented by such security.

The legislative history indicates that Congress may have intended to foreclose constructive-trust claims by defrauded shareholders to the extent that such claims would give the shareholders priority over general unsecured creditors. H.R. Rep. No. 595, 95th Cong., 2d Sess. 194-96, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6154-57 (House Report). By enacting §510(b), Congress intended to resolve a "difficult policy question": whether a security holder who seeks to rescind his purchase should "be subordinated to, share *pari passu* with, or have priority over, unsecured creditors. . . ." House Report at 194, 195. After noting that the case law was unsettled and observing that "[t]here is also authority under present law that if a security holder can trace the consideration paid into proceeds of the estate then he can, in straight bankruptcy, either reclaim the consideration or assert a security interest in the proceeds as a secured creditor," House Report at 195, the Committee referred approvingly to the position set out by Professors Slain and Kripke in their article, *The Interface Between Securities Regulation and Bankruptcy—Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors*, 48 N.Y.U.L. Rev. 261 (1973). According to this view, since "the unsecured creditor [relies] on an apparent cushion of equity securities in making the decision to extend credit," the risk of illegality in securities issuance should be borne by the securities purchasers, not the general creditors. House Report at 195. "The general creditors have not had the potential benefit of the proceeds of the

enterprise deriving from ownership of the securities and it is inequitable to permit shareholders that have had this potential benefit to shift the loss to general creditors." *Ibid.*

The appellants respond that §510(b) was not intended to apply in the situation presented here. They assert that §510(b) is irrelevant to the threshold question whether particular property is properly included in the estate, but addresses only the priority of claims "for purposes of distribution" once the composition of the estate has been determined. Under the appellants' view, §510(b) properly applies only where defrauded investors cannot trace a *res* upon which to impose a constructive trust. Further, they argue that the rationale of the Slain/Kripke view fails here, because no creditor relied on the "equity cushion" provided by the June 1982 purchasers, and because those purchasers got no benefit from their investment, since the SEC halted trading and the cases against FTC were filed almost immediately thereafter.

It appears that no reported opinion addresses the precise question presented here. *But cf. In re U.S. Financial Inc.*, 648 F.2d 515, 517-21 (9th Cir. 1980), *cert. denied*, 451 U.S. 970 (1981) (holding that, under prior law but using Slain/Kripke analysis, absolute-priority rule defeated claim for rescission and reclamation, even though *res* could be traced). We need not resolve it now. We merely hold that there was a substantial question whether Drexel-Moseley would prevail on its constructive-trust claim.¹¹ The constructive-trust claim was not so strong as to make it an

¹¹For this reason, we reject the appellants' argument that the notice of the proposed settlement was deficient because it failed to advise the class members of the high likelihood of success on the constructive-trust claim. "[T]he notice may consist of a very general description of the proposed settlement, including a summary of the monetary or other benefits that the class would receive and an estimation of attorneys' fees and other expenses." *Grunin, supra*, 513 F.2d at 122. The notice sent in this case fully satisfied this standard. Nor, in view of the history of this litigation, do we believe that the time between the giving of notice and the hearing was unduly short. See *id.* at 121.

abuse of discretion to approve a settlement that roughly splits it in half. This conclusion is strengthened by the fact that the great majority of the purchasers of the June 1982 offerings—the parties who would benefit most from the unqualified success of the constructive-trust theory—support the settlement and urge its approval.

D. DISCRIMINATION AGAINST DEFENDANTS

Reavis & McGrath and the Adams Group argue that the Sharing Agreement unfairly discriminates against them by excluding them from participation in Fund B, which consists of the creditors' share of recoveries from FTC's officers, directors, underwriters, and so forth. These appellants argue that, while they are defendants in the FTC litigation, they also have claims for indemnification and in tort and contract. They assert that they should not be treated differently from other creditors merely because they are also defendants. They emphasize that they have not been found guilty of any wrongdoing.

Appellees seek to defend this aspect of the Sharing Agreement by asserting that they have a right to agree among themselves to pool money that they recover from FTC's officers, directors, underwriters, and the like, and to divide up the pool as they see fit. The Agreement, they say, has nothing to do with the bankruptcy estate. It simply creates a separate fund out of money that would never have been in the bankruptcy estate in the first place, and provides for the division of this fund. Thus, claimants against the bankruptcy estate cannot be hurt by and can have no interest in this aspect of the Sharing Agreement. To the extent that Fund B is composed of recoveries by persons other than the trustee on behalf of FTC, this argument has merit. The persons who secure these recoveries are completely free to divide them in any way they see fit. The difficulty with the argument, however, is that some of the money recovered by FTC itself, or by its trustee or

debtor-in-possession, from officers and directors, underwriters, accountants, lawyers, and so forth, also goes into Fund B. These recoveries would otherwise be part of the bankruptcy estate, and the effect of the Sharing Agreement is to exclude certain creditors from full participation in them.

We cannot agree that appellants in the position of the Adams Group and Reavis & McGrath can be excluded altogether from participation in this latter class of recovery simply because they have been named as defendants in suits brought as a result of the FTC debacle. A court of bankruptcy has, to be sure, the right to approve settlements, and may do so, in a proper case, over the objection of some parties, so long as a settlement is found to be in the best interests of the estate as a whole. In the present case, however, we know nothing of the merits of any of the claims made against the "outside" directors, to take one example. This aspect of the settlement, therefore, cannot be justified by the same kind of reasoning used in our discussion of the construction-trust argument. It was possible, with respect to that aspect of the settlement agreement, to weigh the respective merits of each side of the legal dispute and decide whether the settlement was fair and reasonable in view of the likelihood of either side's success. The record contains no information that would enable us to perform a similar operation with respect to the disputed aspects of Fund B, and the District Court's order contains no findings on this subject. If a non-management director of FTC, to take one instance as an illustration, is wrongly accused of wrongdoing and is ultimately vindicated, and if the by-laws of FTC provide that such a director is entitled to indemnification for the costs and expenses of the unsuccessful suit against him, we see no reason, at least so far as the record has been developed to date, why his claim for indemnity should be *a priori* treated differently from, and less advantageously than, the claims of other creditors of FTC.

Of course, the principles of equitable subordination, now codified in 11 U.S.C. §510(c) (1982), will continue to apply, and

the bankruptcy court is free, in later proceedings, to determine upon a proper record that the claims of particular defendants should be subordinated to the claims of other creditors. See, e.g., *Pepper v. Litton*, 308 U.S. 295 (1939); *Farmers Bank v. Julian*, 383 F.2d 314, 322-23 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967).

V. CONCLUSION

In sum, the success of Drexel-Moseley's constructive-trust claim was problematical. Both the June 1982 purchasers and the creditors were at risk of losing the entire Escrow Fund. The June 1982 purchasers, the prospective beneficiaries of the constructive trust, urged that the compromise be approved. The Sharing Agreement forecloses litigation on the constructive-trust issue, and does not appear to increase the complexity or likely duration of the portion of the case that remains to be litigated. In these circumstances, the District Court wisely exercised its discretion in approving the division of the Escrow Fund. Similarly, the division of the creditors' allotment into Fund A and Fund B, insofar as Fund B is comprised of monies that would not be part of the bankrupt's estate in any event, is likewise fair, adequate, and reasonable, and the District Court's approval of that aspect of the Sharing Agreement is also affirmed.

Nevertheless, the exclusion of defendants who are also creditors, and who did not agree to the Sharing Agreement, from sharing in that portion of Fund B attributable to FTC's recoveries from defendants cannot be allowed to stand. To the extent that they approve this aspect of Fund B, the orders of the District Court are vacated, and the cause will be remanded for such further proceedings as may be just, not inconsistent with this opinion. We assume that this aspect of the Sharing Agreement is relatively minor, from the point of view of the parties who signed the Agreement. The major effect of the Agreement remains undisturbed, and if our assessment of the relative importance of the

issues on appeal is correct, the appellees will remain satisfied with the Agreement, even if it must ultimately be modified in respect of one aspect of the disposition of Fund B. If, however, appellees believe that our disapproval of the exclusion of the defendants from participation in those assets of FTC allocated to Fund B seriously compromises the value of their bargain under the Sharing Agreement, they may apply for appropriate relief in the district court or the bankruptcy court, as the case may be.

Affirmed in part, vacated in part, and remanded. The appellants Reavis & McGrath and the Adams Group shall be entitled to recover their costs against appellees and intervenors. Appellees and intervenors shall be entitled to recover their costs against appellants Drexel-Moseley and Fox & Co. In all other respects the parties shall bear their own costs.

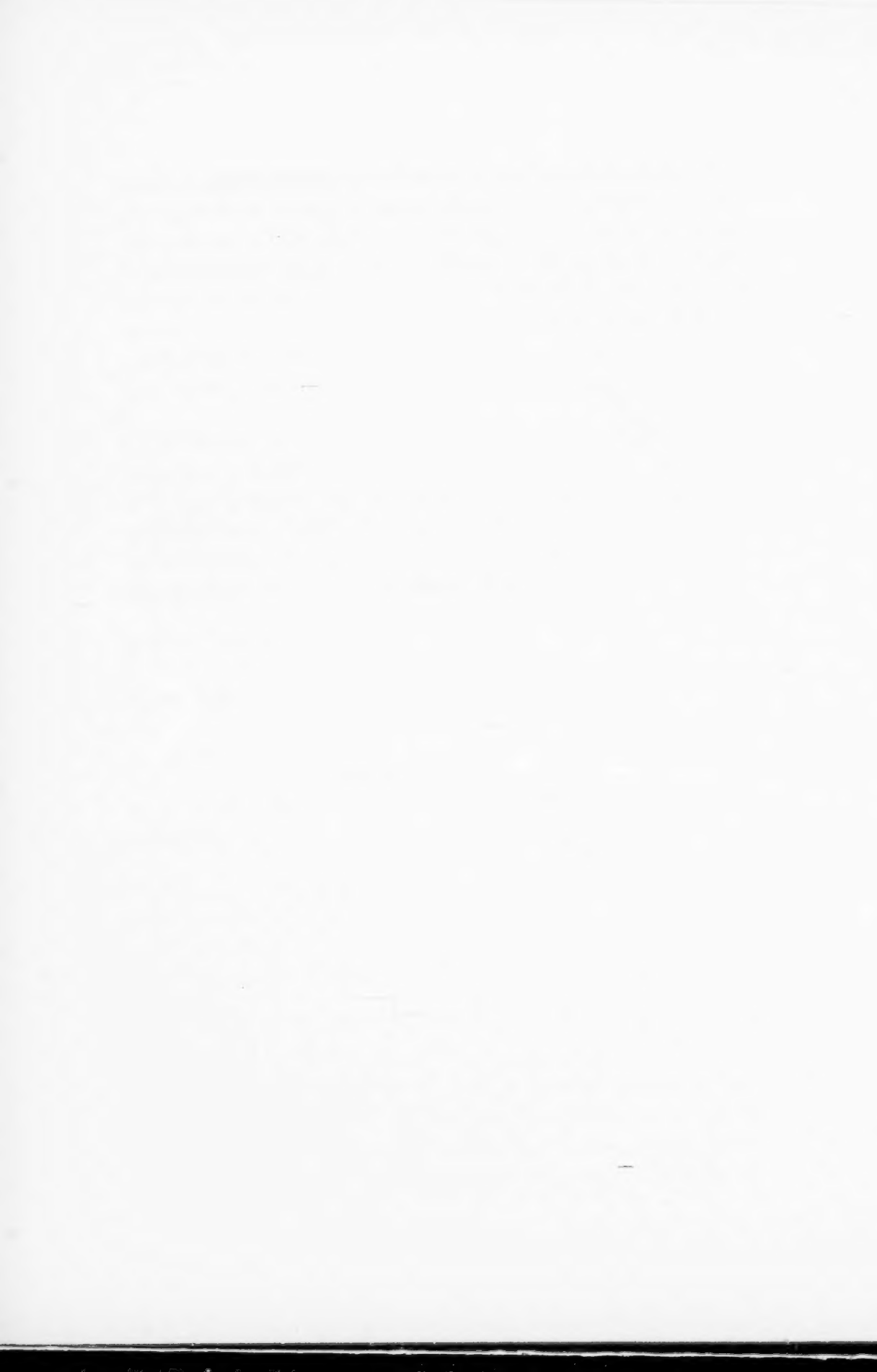
It is so ordered.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH
CIRCUIT.

APPENDIX B



United States Court of Appeals
FOR THE EIGHTH CIRCUIT

83-2121-MN.

September Term, 1983

IN RE FLIGHT TRANSPORTATION CORPORATION SECURITIES LITIGATION

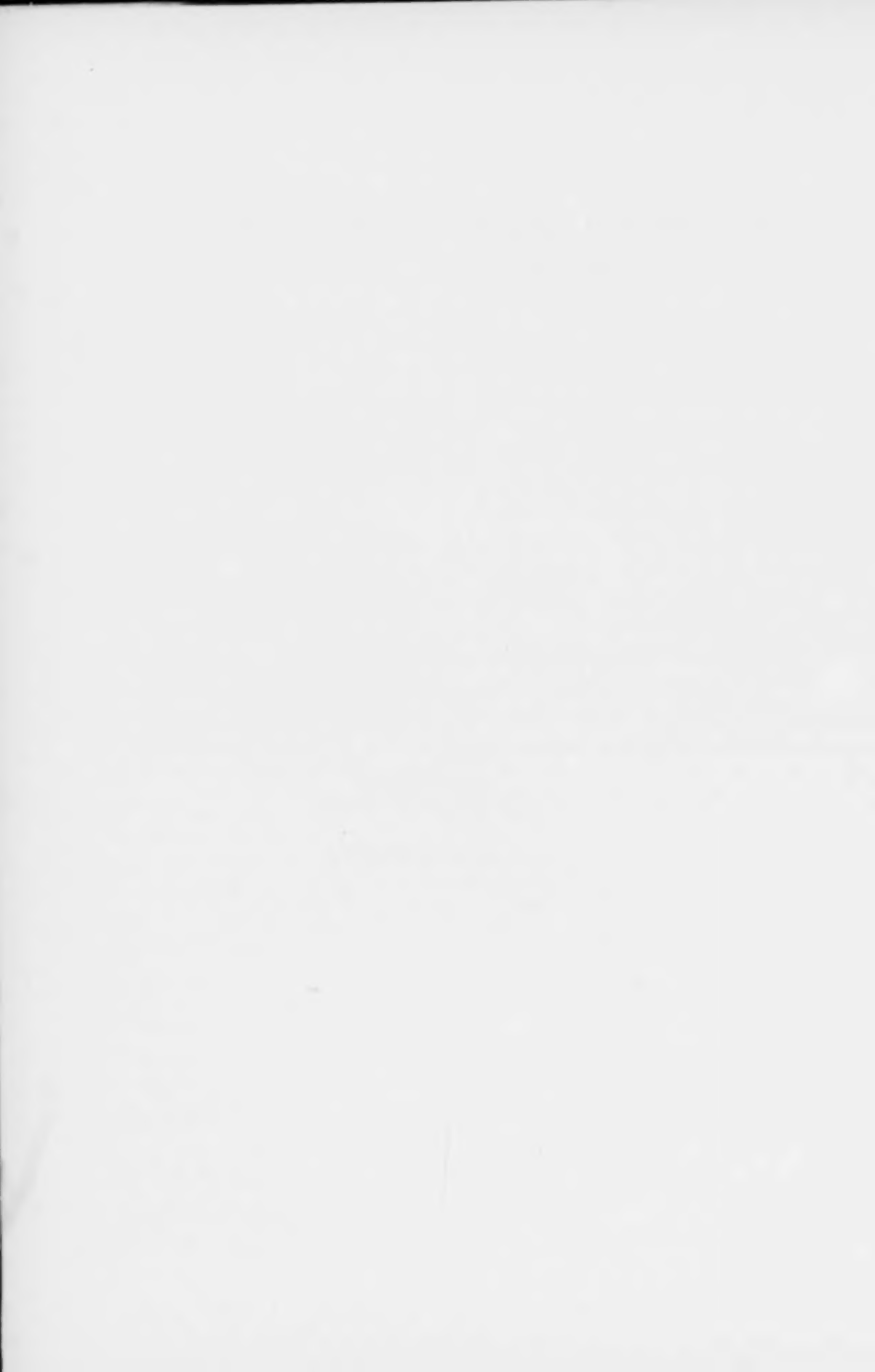
} Appeal from the United States
District Court for the District of Minnesota

REAVIS & McGRATH,

Appellant.

The Court, having considered appellant's petition for rehearing and suggestion of rehearing en banc and being now fully advised in the premises, hereby orders the petition for rehearing and suggestion of rehearing en banc denied.

May 25, 1984



APPENDIX C



**UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION**

**IN RE FLIGHT TRANSPORTATION CORPORATION
SECURITIES LITIGATION**
Master Docket No. 4-82-874

PRETRIAL ORDER #153

**MEMORANDUM AND ORDER GRANTING
PLAINTIFF CLASS CERTIFICATION**

This matter is before the Court pursuant to the motion of the Plaintiffs' Steering Committee seeking certification of a class of purchasers of Flight Transportation Corporation Securities with five subclasses.

Pursuant to Pretrial Order No. 141, all parties to this litigation were advised of a briefing schedule with respect to the class certification issue. Pretrial Order No. 141 also established June 27 as the date for hearing on the class certification issue.

In Pretrial Order No. 142, this Court preliminarily found that this action should be maintained as a class action. The class and subclasses set forth in Pretrial Order No. 142, were, pursuant to Rule 23 of the Federal Rules of Civil Procedure preliminarily established.

Pretrial Order No. 142 also directed that notice be given to potential class members. Plaintiffs have filed affidavits indicating

Filed 7-20 1983
Robert E. Hess, Clerk

By _____ Xx _____
Deputy

the mailing and publication of notice consistent with Pretrial Order Nos. 142 and 144. The Court, having considered all affidavits, memoranda and motions on the class certification issue, including the alternative motion for class certification submitted by attorneys representing Drexel, Burnham, Lambert Incorporated and Moseley, Hailgarten, Estabrook & Weeden, Inc. (hereinafter "Drexel and Moseley") makes the following:

FINDINGS OF FACT

1. That the members of the proposed plaintiffs' class and subclasses are each so numerous that joinder of all the members thereof is impracticable.
2. That there are questions of law and fact common to the class and each of the subclasses.
3. That the claims of each proposed representative party are typical of the claims of the class or subclass that the plaintiffs seek to have him or it represent.
4. That each proposed representative party will fairly and adequately protect the interests of the class or subclass that the plaintiffs seek to have him or it represent.
5. That each proposed subclass defined below is contained within the class and is defined separately for purposes of asserting claims particular to each subclass and for purposes of allocating among the subclasses amounts recovered pursuant to this litigation.
6. That the questions of law and fact common to the members of the proposed class and each proposed subclass predominate over any questions affecting only individual members thereof.
7. That a class action is a superior method to all other available methods for the fair and efficient adjudication of the controversy.

In view of the foregoing, IT IS HEREBY ORDERED:

1. That this action shall be maintained as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure.
2. That the following class, subclasses, class representatives and counsel for class representatives are hereby certified, established and appointed.

A. The Class

All persons who purchased Flight Transportation Corporation ("FTC") securities during the period from November 30, 1979, to June 18, 1982, and suffered a loss from such purchase, excluding all defendants named in the Consolidated Action or any related action; all members of the immediate families of any individuals named as defendants therein, or of any other individuals excluded from the class defined therein; all partners, officers, and/or directors of any entities named as defendants therein, or of any other entities excluded from the class defined therein; all entities in which any defendant or any other individual or entity excluded from the class defined therein has a controlling interest; all persons who purchased or otherwise own any FTC securities on behalf of any defendant therein, or any other individual or entity excluded from the class defined therein; and all other individuals or entities found culpable of wrongdoing in the Consolidated Action or any related action.

B. Subclass I.

All Class Members who purchased, directly or in the aftermarket, common stock of FTC issued pursuant to a Registration Statement declared effective by the SEC on or about November 30, 1979.

C. Subclass II.

All Class Members who purchased, directly or in the aftermarket, common stock and/or warrants to purchase common stock of FTC offered as units of securities of FTC, each unit consisting of one share of common stock of FTC and one half of a warrant to purchase one share of common

stock of FTC, issued pursuant to a Registration Statement declared effective by the SEC on or about March 2, 1981.

D. Subclass III.

All Class Members who purchased, directly or in the aftermarket, common stock of FTC issued pursuant to a Registration Statement declared effective by the SEC on June 3, 1982.

E. Subclass IV.

All Class Members who purchased, directly or in the aftermarket, debentures and/or warrants to purchase common stock of FTC offered as units of securities of FTC, each unit consisting of a \$1,000 principal amount 11¼% Sinking Fund Debenture due June 1, 1995, and warrants to purchase 57 shares of FTC common stock issued pursuant to a Registration Statement declared effective by the SEC on June 4, 1982.

F. Subclass V.

All Class Members who are not included in any of Subclasses I, II, III or IV, defined above.

That the plaintiffs and plaintiffs' counsel set forth below be designated as representatives for the plaintiff Class and Subclasses as indicated:

Class or Subclass	Representatives	Counsel
A. The Class	All plaintiffs named in the Consolidated Complaint, Master Docket No. 4-82-874, and Putnam High Yield Trust, United High Income Fund, Inc., and Oppenheimer High Yield Fund, plaintiffs in case No. 4-82-1052	Plaintiffs' Steering Committee and Committee of the Whole as designed by this Court's pretrial Order No. 20, with the addition of James C. Diracles to Plaintiffs' Steering Committee pursuant to the Sharing Agreement

Class or Subclass	Representatives	Counsel
B. Subclass I.	Allen Ziskin Master Docket No. 4-82-874	John Cochrane Cochrane & Bresnahan 360 Wabasha Street St. Paul, MN 55102 Daniel W. Krasner Wolf Haldenstein Adler Freeman & Herz 270 Madison Avenue New York, NY 10016
C. Subclass II.	Stanley Koutek Dennis Barr Master Docket No. 4-82-874	John A. Cochrane Daniel W. Krasner
D. Subclass III.	Denis A. Koltun Bruce Shankman R. I. Schwarzschild Dolores and Robert Bezark Master Docket No. 4-82-874	Lowell B. Sachnoff Sachnoff, Weaver & Rubenstein, Ltd. One IBM Plaza Chicago, IL 60611 Jack L. Chestnut Chestnut & Brooks 900 Midland Bank Building Minneapolis, MN 55401
E. Subclass IV.	Putnam High Yield Trust United High Income Fund, Inc. Oppenheimer High Yield Fund Court File No. 4-82-1052	James C. Diracles Best & Flanagan 4040 IDS Center Minneapolis, MN 55402

Class or Subclass	Representatives	Counsel
F. Subclass V.	Ronald Knuth Emil Gotschlich Master Docket No. 4-82-874	John A. Cochran Daniel W. Krasner Thomas P. Gallagher 1500 Midwest Plaza West Minneapolis, MN 55402

3. In view of the foregoing, the alternative class motion of Drexel and Moseley is denied. Drexel and Moseley do not qualify as class representatives pursuant to Rule 23.

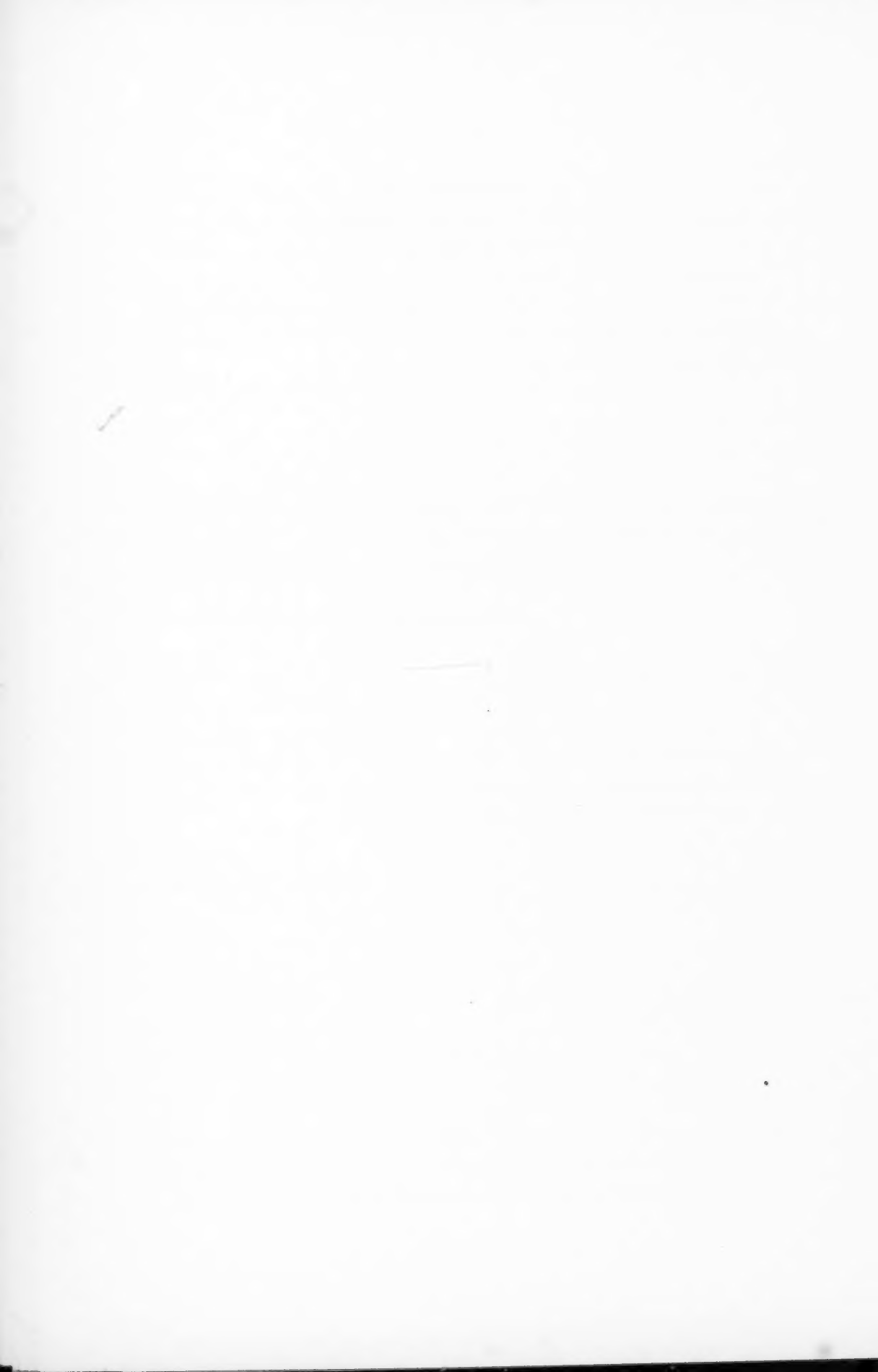
IT IS SO ORDERED.

BY THE COURT

/s/ CHARLES R. WEINER
The Honorable Charles R. Weiner
United States District Judge

Dated: July 15, 1983.

APPENDIX D



**UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION**

**IN RE FLIGHT TRANSPORTATION CORPORATION
SECURITIES LITIGATION
Master Docket No. 4-82-874**

PRETRIAL ORDER # 154

**ORDER APPROVING THE SHARING AGREEMENT
AS A SETTLEMENT PURSUANT TO
FEDERAL RULES OF CIVIL PROCEDURE 23(e)**

Pursuant to Pretrial Order No. 131, this Court preliminarily approved the Sharing Agreement and directed that a hearing be held on June 27, 1983, pursuant to Rule 23 of the Federal Rules of Civil Procedure and applicable provisions of the United States Bankruptcy Code for the purpose of determining whether the proposed Sharing Agreement is fair, reasonable and adequate and should be finally approved.

Pursuant to Pretrial Orders No. 142 and 144, notice was sent to all identifiable individuals that may be members of the proposed class. On Friday, June 10, 1983, a summary notice was published in the Wall Street Journal, national edition. Pursuant to the United States Bankruptcy Code, notice was sent to all debtors, creditors and other parties in interest on June 4, 1983 advising them of the hearing date of June 27, at which time the fairness and adequacy of the Sharing Agreement as a settlement would be considered by the Court.

Upon thorough consideration of the Sharing Agreement and the briefs, memoranda, affidavits and arguments of all parties and all objections voiced to the Sharing Agreement,

IT IS HEREBY ORDERED as follows:

1. The Sharing Agreement preliminarily approved in Pretrial Order No. 131, which was filed with the Court on April 21, 1983, is found to be a fair, adequate and reasonable settlement.
2. Pursuant to Rule 23(e) of the Federal Rules of Civil Procedure, the Sharing Agreement is approved as a partial settlement of these proceedings.
3. The parties to the Sharing Agreement are directed to proceed to implement provisions of the Sharing Agreement.

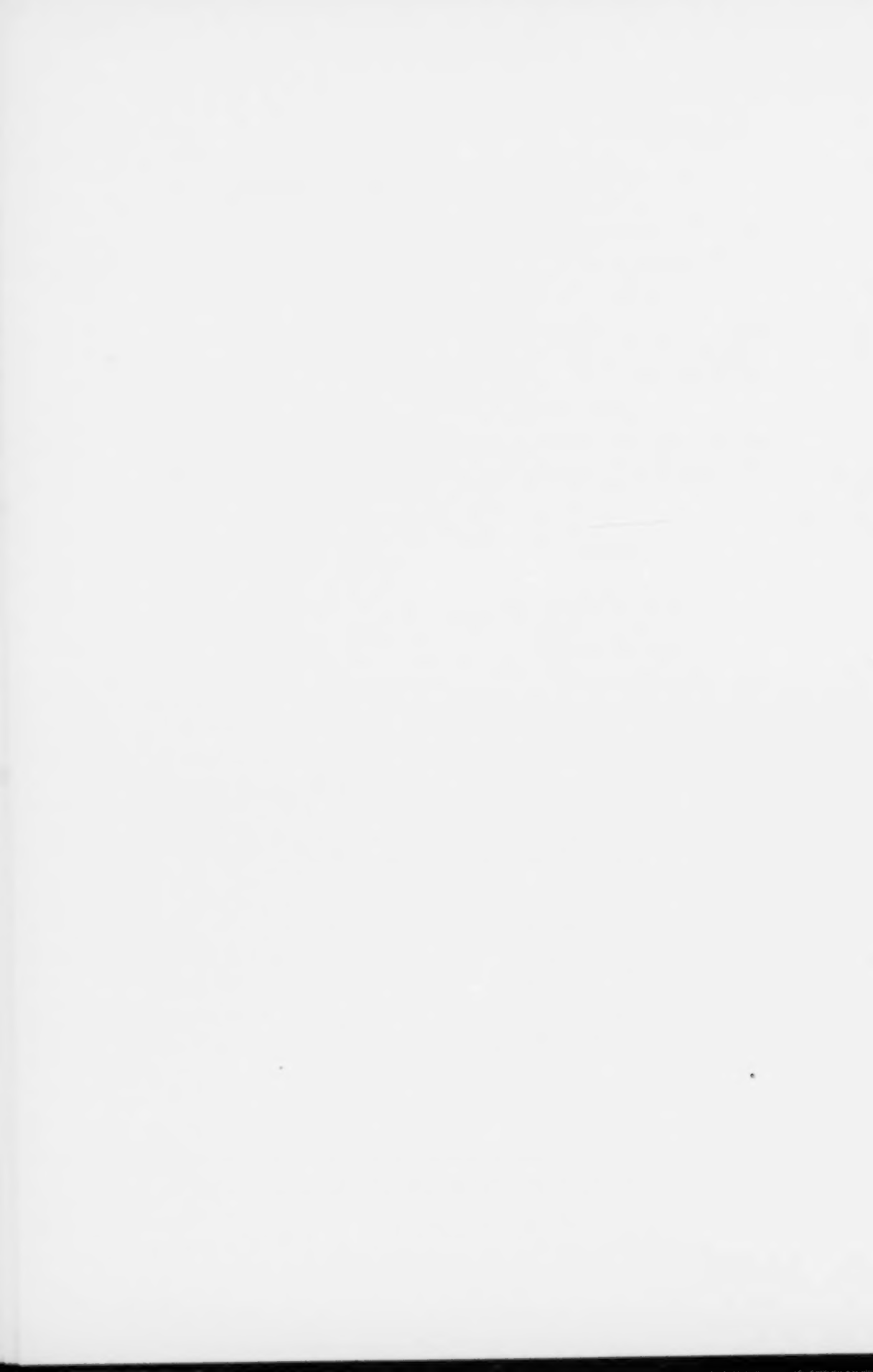
BY THE COURT

/s/ CHARLES R. WEINER

The Honorable
Charles R. Weiner
United States District Judge

Dated: July 15, 1983.

APPENDIX E



**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION**

In re:

Flight Transportation Corporation	Bky. No. 4-82-1154
FTC, Two Jacks, Inc.	Bky. No. 4-83-954
FTC, Walston Wings, Inc.	Bky. No. 4-83-952
FTC, Moline, Inc.	Bky. No. 4-83-951
FTC, Helicopters, Inc., f/k/a	
Hervert Helicopters, Inc.	Bky. No. 4-83-956
FTC, Executive Air Charters, Inc.	Bky. No. 4-83-950
Flight Training Center, Inc.	Bky. No. 4-83-949
Jet Set Athletic Club, Inc.	Bky. No. 4-83-953
International Contractors Corporation	Bky. No. 4-83-957
FTC, Airport Systems,	Bky. No. 4-83-955

Debtors.

**ORDER AUTHORIZING DEBTOR-IN-POSSESSION
TO BECOME A PARTY TO SHARING AGREEMENT
DATED APRIL 15, 1983**

Pursuant to due notice thereof to all creditors and other known interested parties, hearing was held before the undersigned on June 27, 1983, at Minneapolis, Minnesota, upon the application of Thomas C. Bartsh, debtor-in-possession of the above estates, for an order authorizing said debtor-in-possession to become a party to that certain Sharing Agreement dated as of April 15, 1983. After hearing all persons desiring to be heard thereon and being advised in all the premises and being satisfied that it is in the best interests of this estate and creditors and other interested

parties that the debtor-in-possession and this estate become party to said Sharing Agreement, it is

ORDERED: Thomas C. Bartsh, the duly designated debtor-in-possession of the above estate, be and he hereby is authorized to become a party to that certain Sharing Agreement dated as of April 15, 1983, and thereby bind this estate and any successor representative of said estate to the terms and conditions of said Sharing Agreement and is further authorized to execute such other documents, including transfer or assignment of claims of this estate, and to do all other things as may be reasonably required by the terms of said Sharing Agreement.

Dated: July 15, 1983.

BY THE COURT

/s/ CHARLES R. WEINER

Charles R. Weiner

APPENDIX F



STATUTES

United States Code, Title 11

§363. Use, sale, or lease of property

(b) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

§510. Subordination

(b) Any claim for rescission¹ of a purchase or sale of a security of the debtor or of an affiliate or for damages arising from the purchase or sale of such a security shall be subordinated for purposes of distribution to all claims and interests that are senior or equal to the claim or interest represented by such security.

§541. Property of the estate

(b) Property of the estate does not include any power that the debtor may only exercise solely for the benefit of an entity other than the debtor.

§702. Election of trustee

(b) At the meeting of creditors under section 341 of this title, creditors may elect one person to serve as trustee in the case if election of a trustee is requested by creditors that may vote under subsection (a) of this section, and that hold at least 20 percent in amount of the claims specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section.

§726. Distribution of property of the estate

(a) Except as provided in section 510 of this title, property of the estate shall be distributed—

(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title;

(2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is—

(A) timely filed under section 501(a) of this title;

(B) timely filed under section 501(b) or 501(c) of this title; or

(C) tardily filed under section 501(a) of this title, if—

(i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and

(ii) proof of such claim is filed in time to permit payment of such claim;

(3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title, other than a claim of the kind specified in paragraph (2)(C) of this subsection;

(4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim;

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection; and

(6) sixth, to the debtor.

(b) Payment on claims of a kind specified in paragraph (1), (2), (3), (4), (5), or (6) of section 507(a) of this title, or in paragraph (2), (3), (4), or (5) of subsection (a) of this section, shall be made pro rata among claims of the kind specified in a particular paragraph, except that in a case that has been converted to this chapter under section 1112 or 1307 of this title, administrative expenses incurred under this chapter after such conversion have priority over administrative expenses incurred under any other chapter of this title or under this chapter before such conversion and over any expenses of a custodian superseded under section 543 of this title.

(c) Notwithstanding subsections (a) and (b) of this section, if there is property of the kind specified in section 541(a)(2) of this title, or proceeds of such property, in the estate, such property or proceeds shall be segregated from other property of the estate, and such property or proceeds and other property of the estate shall be distributed as follows:

(1) Administrative expenses shall be paid either from property of the kind specified in section 541(a)(2) of this title, or from other property of the estate, as the interest of justice requires.

(2) Claims other than for administrative expenses shall be paid in the order specified in subsection (a) of this section, and, with respect to claims of a kind specified in a particular paragraph of section 507 of this title or subsection (a) of this section, in the following order and manner:

(A) First, community claims against the debtor or the debtor's spouse shall be paid from property of the kind specified in section 541(a)(2) of this title, except to the extent that such property is solely liable for debts of the debtor.

(B) Second, to the extent that community claims against the debtor are not paid under subparagraph (A) of this paragraph, such community claims shall be paid from property of the kind specified in section 541(a)(2) of this title that is solely liable for debts of the debtor.

(C) Third, to the extent that all claims against the debtor including community claims against the debtor are not paid under subparagraph (A) or (B) of this paragraph such claims shall be paid from property of the estate other than property of the kind specified in section 541(a)(2) of this title.

(D) Fourth, to the extent that community claims against the debtor or the debtor's spouse are not paid under subparagraph (A), (B), or (C) of this paragraph, such claims shall be paid from all remaining property of the estate.

§727. Discharge

(a) The court shall grant the debtor a discharge, unless—

(1) the debtor is not an individual;

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

(3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

(4) the debtor knowingly and fraudulently, in or in connection with the case—

(A) made a false oath or account;

(B) presented or used a false claim;

(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or

(D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case—

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or

(C) on a ground other than the property¹ invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case concerning an insider;

(8) the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371 or 476 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition;

(9) the debtor has been granted a discharge under section 1328 of this title, or under section 660 or 661 of the Bankruptcy Act, in a case commenced within six years before the

date of the filing of the petition, unless payments under the plan in such case totaled at least—

(A) 100 percent of the allowed unsecured claims in such case; or

(B)(i) 70 percent of such claims; and

(ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort; or

(10) the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter.

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

(c)(1) The trustee or a creditor may object to discharge under subsection (a) of this section.

(2) On request of a party in interest, the court may order the trustee to examine the acts and conduct of the debtor to determine whether a ground exists for denial of discharge.

(d) On request of the trustee or a creditor, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if—

(1) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;

(2) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be

property of the estate, and knowingly and fraudulently failed to report the acquisition of, or entitlement to, such property, or to deliver or surrender such property to the trustee; or

(3) the debtor committed an act specified in subsection (a)(6) of this section.

(e) The trustee or a creditor may request a revocation of a discharge—

(1) under subsection (d)(1) of this section, within one year after such discharge was granted; or

(2) under subsection (d)(2) or (d)(3) of this section, before the later of—

(A) one year after the granting of such discharge; and

(B) the date the case is closed.

§1125. Postpetition disclosure and solicitation

(a) In this section—

(1) “adequate information” means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor’s books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan; and

(2) “investor typical of holders of claims or interests of the relevant class” means investor having—

(A) a claim or interest of the relevant class;

(B) such a relationship with debtor as the holders of other claims or interests of such class generally have; and

(C) such ability to obtain such information from sources other than the disclosure required by this section as holders’ claims or interest in such class generally have.

(b) An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets.

(c) The same disclosure statement shall be transmitted to each holder of a claim or interest of a particular class, but there may be transmitted different disclosure statements, differing in amount, detail, or kind of information, as between classes.

(d) Whether a disclosure statement contains adequate information is not governed by any otherwise applicable nonbankruptcy law, rule, or regulation, but an agency or official whose duty is to administer or enforce such a law, rule, or regulation may be heard on the issue of whether a disclosure statement contains adequate information. Such an agency or official may not appeal from an order approving a disclosure statement.

(e) A person that solicits, in good faith and in compliance with the applicable provisions of this title, or that participates, in good faith and in compliance with the applicable provisions of this title, in the offer, issuance, sale, or purchase of a security, offered or sold under the plan, of the debtor, of an affiliate participating in a joint plan with the debtor, or of a newly organized successor to the debtor under the plan, is not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing the offer, issuance, sale, or purchase of securities.

§ 1126. Acceptance of plan

(a) The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan. If the United States is a

creditor or equity security holder, the Secretary of the Treasury may accept or reject the plan on behalf of the United States.

(b) For the purposes of subsections (c) and (d) of this section, a holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan, as the case may be, if—

(1) the solicitation of such acceptance or rejection was in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with such solicitation; or

(2) if there is not any such law, rule, or regulation, such acceptance or rejection was solicited after disclosure to such holder of adequate information, as defined in section 1125(a)(1) of this title.

(c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

(d) A class of interests has accepted a plan if such plan has been accepted by holders of such interests other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount of the allowed interests of such class held by holders of such interests, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

(e) On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.

(f) Notwithstanding any other provision of this section, a class that is not impaired under a plan is deemed to have accepted the plan, and solicitation¹ of acceptances with respect to such class from the holders of claims or interest² of such class is not required.

(g) Notwithstanding any other provision of this section, a class is deemed not to have accepted a plan if such plan provides that the claims or interests of such class do not entitle the holders of such claims or interests to any payment or compensation under the plan on account of such claims or interests.

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

* * *

(7) With respect to each class—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such creditor's interest in the estate's interest in the property that secures such claims.

* * *

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

* * *

(B) With respect to a class of unsecured claims—

,

F-11

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain on account of such junior claim or interest any property.